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# Understanding When A Taxpayer Should Be Issued a W-2 Form vs. Form 1099-MISC

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# Independent Contractor or Employee

**Issue:** *Withholding* of income taxes,  
Social Security and Medicare vs. not  
*Matching* of Social Security & Medicare  
and **payment** of Unemployment taxes

Business *relationship* between worker  
and provider of work

**Reg. 1.31.3401(c) & Rev. Rul. 72-88**

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# Common Law Rules: 20 Factor Test

**Behavioral:** *Control or right to control what worker does and how it is done*

**Financial:** *Control of business aspects (how paid, expense reimbursements, providing of tools & supplies)*

**Type of Relationship:** *Written contracts or employee type benefits, work a key aspect of business operations*

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# Behavioral Control

Facts that show a “*right*” to direct or control  
“*how*” worker does the work

*Factors:* type of instruction, degree of  
instruction, evaluation system and  
training

*Type of instruction:* when, where and how

*Degree of instruction:* the more detail given  
then more indication of an employee

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# Behavioral Control

*Evaluation System:* measuring of details (employee) vs. measuring end result (independent contractor)

*Training:* business provides worker with training on “*how*” (*employee*) vs. own methods (independent contractor)



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# Financial Control: Economic Aspects

Significant investment: *Could* indicate I/C status but industry could be a factor e.g. construction

Unreimbursed expenses: *Could* indicate I/C status but many employees incur fixed costs

Opportunity for profit of (loss): I/C run the risk of excess costs over revenues

Services to the market: I/C generally need to seek out new business



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# Type of Relationship: Perception

*Written contracts:* determined by “*how*” the parties work together

*Employee benefits:* insurance, pensions, disability, paid vacations not granted to I/C

*Permanency of relationship:* expectation that relationship is indefinite generally indicates employee

*Services provided are key aspect of business operation:* generally indicates employee

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# Facts & Circumstances Determination

All factors weighed independently in each case

No “magic” or set number of factors  
“makes” a worker an employee or an independent contractor

“20 Factor Test” *indicates* the degree of control and varies depending on occupation and factual context in which services performed



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# Facts & Circumstances Determination

Designed only as a “guide”: special  
scrutiny required to determine  
*“substance over form”*

*Industry practice* or custom in area of  
parties involved

*Intent* of the parties

*Written, signed independent contractor  
agreements executed*

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# FORM SS-8

Used if after reviewing the 3 categories of evidence (Behavioral, Financial, Type of relationship) the status of worker still unclear

If used, then the IRS reviews the facts and circumstances and determines the status of the worker?

Can be filed by either worker or provider of work

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# Misclassification of Employees

**Sec. 3509:** imposes penalties on the payer if a worker is classified as an independent contractor and there is no reasonable basis

**Sec. 530 Relief Provisions: Publication 1976**

**Form 8919**

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# Section 530 Relief Requirements

*Reasonable basis:* court case, ruling issued to taxpayer by IRS, audited by IRS on employment issues, industry practice, reliance on advice of lawyer or accountant

*Substantive consistency:* treated all workers performing similar functions the same way

*Reporting consistency:* filed all required federal tax forms consistent with treatment of each worker (Filed Form 1099 MISC)

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# References

**IRS Website: Small Business, Self-employed**

**IRS Publication 15-A:** *“Employer’s Supplemental Tax Guide* (Supplement to Publication 15 (Circular E), Employer’s Tax Guide)

**IRS Internal Training Manual:**

*“Employee/Independent Contractor Manual”* (PDF) 160 pages

**Form W-9:** *“Request for Taxpayer Identification Number and Certification”*